



Statewide Accounting Policy & Procedure

Accounting Manual Reference:

Section: Leases
Sub-section: Capital Leases Overview

Effective Date: 07/01/1999

Revision Date: 07/01/2004

Georgia Laws

- OCGA 50-5-64: Multiyear contracts authorized; standard form provisions; what funds obligated; interest
- OCGA 50-5-65: Transfer of personal property titles to effectuate lease purchases; authority; form

Definition of a Capital Lease

A lease should be accounted for as a capital lease if it is an "in-substance purchase"; when all the risks and benefits of ownership are assumed by the lessee. Statement 13 issued by the Financial Accounting and Standards Board (FASB) States that at least one of four criteria listed below should be met in the lease agreement provisions for the agreement to be classified as a capital lease:

- (1) The lease transfers ownership of property to lessee by the end of the lease term, (for capital lease purchases of land this criterion must be met).
- (2) The lease contains bargain purchase option, (i.e., the option price of the asset will be so much lower than the market price that the option will almost certainly be exercised).
- (3) The lease term is equal to 75% or more of the estimated economic life of the leased property (this criterion does not apply if the asset is already in the last quarter of its economic life).
- (4) The present value, at the beginning of the lease term, of the minimum lease payments exceeds 90% of the fair value of the leased property at the inception of the lease. This criterion excludes executory costs (i.e., costs related to the leased asset, such as insurance and maintenance). It is required that the lessee will use their own incremental borrowing rate as a discount rate when calculating the present value unless the lessee is aware of the lessor's implicit rate of return and the lessor's rate of return is less than the lessee's implicit rate.

Refer to Accounting Directive 201002, *Definition of Lease Term and Leases Associated with Copier Machines/Postage Meters*, for additional guidance on application of this definition by organizations in the State of Georgia reporting entity. The directive is posted on the SAO website at: SAO.georgia.gov > [Policies > Accounting Directives](#).

Accounting Procedures in General

Principal and interest payments for capital leases are recorded when payment is made. Under GAAP, capital leases are accounted for in a manner similar to debt transactions. Significant variance between GAAP and the State's budgetary basis of accounting are discussed below.

Governmental Funds

Capital leases accounted for in governmental funds should be treated in the same manner as long-term debt. The net present value of the minimum lease payments should be recorded as both an "other financing source" and an "expenditure" even though no financial resources were actually received or disbursed.

Proprietary Funds, Fiduciary Funds and Component Units

Capital lease accounting for proprietary funds, fiduciary funds and component units should follow FASB Statement 13, without modification. All assets and liabilities of these funds should be accounted for and reported in the respective funds. Therefore, capital lease transactions are accounted for and reported entirely within the individual funds.

Fiscal Funding Clauses

Lease agreements must be noncancellable to qualify as capital leases under FASB Statement 13. Most State leases must contain "fiscal funding clauses" which allows the State organization to terminate a lease agreement if appropriated funds are not available to fund the lease. In practice, such clauses are typically never exercised. The GASB has determined that the presence of such a clause does not prevent the agreement from being classified as a capital lease, provided that the chances of the clause being invoked are remote.

Refer to Accounting Directive 201002, *Definition of Lease Term and Leases Associated with Copier Machines/Postage Meters*, for additional guidance on the effect of fiscal funding clauses in relation to lease reporting by organizations in the State of Georgia reporting entity.

Synopsis of Significant Variances between GAAP and Budgetary Basis

If GAAP financial statements are not provided, SAO must be furnished with information to meet the following GAAP reporting requirements:

For GAAP reporting purposes, State organizations reported as governmental funds should record other financing sources and equipment expenditures for the net present value of the minimum lease payments. Principal amounts of lease payments due within 12 months should be recorded as a current liability. Periodic lease payments should be recorded as capital lease principal and interest expenditures. Proprietary funds and the government-wide financial statements should report long and short-term payables. Periodic lease payments should be recorded as capital lease principal and interest expense (Provide a listing of all capital leases entered into in the current year, including a schedule of lease payments – principal and interest. Provide a detail of amounts/accounts related to current year payments on capital leases).

Year-end reporting forms are provided on the SAO website at SAO.Georgia.gov > [Reporting](#) > [Year-End Reporting](#) > [Reporting Forms](#).